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Comparative Performance Study of Conventional and Islamic Banking in Egypt

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Abstract

The purpose of this empirical study is to analyze and compare the performance of Islamic and conventional banking in Egypt and to find out which of the banking streams is performing better than the other. To make appropriate comparative analysis, three Islamic banks (Faisal Islamic Bank, ElBaraka Misr, and National Bank for Development) and six conventional banks (National Bank of Egypt, Banque Misr, Bank of Alexandria, National Societe Generale Bank, Arab African International Bank, Commercial International Bank) were used during the period from 2008 to 2010. Financial ratios were estimated from annual reports and financial statements. Seven financial ratios were used to gauge profitability, liquidity and credit risk; and a model known as "Bank-o-meter" was used to gauge solvency. Findings indicate the superiority of conventional banks over Islamic ones in profitability, liquidity, credit risk management as well as solvency.

JEL classification numbers: G21
Keywords: Performance evaluation, Islamic banking, conventional banking, profitability, liquidity, credit risk, solvency.

1 Introduction

Islamic banking started with the establishment of two financial institutions in Mit-Ghamr, in the Nile Delta, and in Karachi from 1963-1967. In 1971, Nasser Social Bank was established as the first bank whose establishment law prohibited interest-based activities. In 1974, an agreement was signed for the establishment of the Islamic Bank for Development

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in Jeddah. This bank was responsible for funding governments and started working in 1975. In the same year, the real progress was made in this movement by the establishment of a full- fledged Islamic bank with the name of Dubai Islamic Bank. By year 2011, the number of Islamic financial institutions reached 500 banks, compared to 267 banks in 2003. Islamic banking got popularity in light of its stability, as compared to conventional banking, during the world financial crisis in 2008. It has also gained approval by international financial institutions (IFI), professional bankers and the academic world. Islamic banking has successfully established its identity and performed its operations distinct from its conventional counterparts. It aims to promote and develop the application of Islamic principles, laws and traditions to transactions of financial, banking and related business affairs. Islamic banks, by doing so, will safeguard the Islamic communities and societies from activities that are forbidden in Islam [1]. Now, Islamic banks are operating and providing Islamic banking services in more than 57 countries all over the world. Furthermore, their assets increased from 250 billion US dollars in 2004 to 319 billion US dollars in 2005, that is with a growth rate of 27%. It is also estimated to be more than one trillion US dollars by 2012. The Islamic banking industry's world-wide annual growth rate is between 15 and 20%, which is considered among the highest industry growth rates in the world.

Although Egypt is considered the birthplace of Islamic finance, its growth has evidently lagged. For under Mubarak's 30-year rule, the country sought to enforce a more secular financial system. According to a 2009 report by consulting firm McKinsey, Islamic banking only accounts for 3 to 4 % of Egypt's $193 billion banking industry. That compares with 46 % in the United Arab Emirates. However, following the Egyptian 25th of January revolution, prospects are rising for Egypt to become a new hub for the booming Islamic finance. The size of Islamic banking reached 95 billion pounds, with an increase of 2.3% as of 2010. The amount of deposits at the Islamic banks reached 85 billion pounds, constituting about 8.6% of total deposits at the Egyptian banking sector. Also, the amount of Islamic finance reached 65 billion pounds, which is about 7.6% of that of the Egyptian banking sector. There are now 14 Egyptian banks, with 211 branches, providing Islamic banking services. They represent 9% of the total branches of banks in Egypt. Three of them are totally Islamic banks, namely, Faisal Islamic Bank, ElBaraka Misr, and National Bank for Development. The rest are conventional banks that either have Islamic branches or provide Islamic banking products.

From here arises the importance of investigating the performance of Islamic banking in Egypt, as compared to that of conventional banking. This is considered crucial for depositors, bank managers, shareholders, investors and regulators in order to provide a true picture of the financial position of Islamic and conventional banks in Egypt. A point worth noting here is that that there is not a single Islamic bank enlisted among the top 100 banks of the world. In fact, the size of Islamic banks is one of the major obstacles of their ability to interact efficiently in international markets, and keep up with increasing developments in providing modern banking services. Therefore, it is indeed inevitable for those in charge of the Islamic banking industry to explore future horizons with the aim of having a clearer vision, predicting both obstacles and challenges and dealing with them effectively.

Financial institutions are very important for any economy because they provide funds needed to keep economies on the path of economic growth and development. Financial ratios are indicators that reflect the financial health of any organization, including banks. Ratio analysis, here, is not only important for depositors, but also for management to

improve future performance of banks. Thus, the purpose of this study is to provide a full picture of the financial position of the Egyptian banking sector, with both its Islamic and conventional streams. Furthermore, it aims at making investors, management and shareholders aware of the performance of Islamic banks as compared to that of conventional ones. Accordingly, the study explores the performance of both streams of banking (conventional and Islamic) in Egypt during the period 2008-2010. In order to study performance, the population is divided into two portfolios namely, conventional and Islamic banks to conduct the analysis. The financial analysis includes measures of profitability, liquidity management, credit risk management and solvency. The suggested indicators for profitability are: Return on Assets (ROA), and Return on Equity (ROE). As for liquidity management, it could be compared using loan to asset ratio (NetLTA), and loan to deposits and borrowings ratio (NetLD&B). Credit risk management indicators include equity to loans ratio (EQL) and percentage of impaired loans to total loans (IMLGL). Finally, to examine solvency, the bank-o-meter adopted by Shar, et al. (2010) is used.

The study is planned as follows: After a comprehensive introduction, structural differences between Islamic and conventional banks, as well as elements of Islamic banking and finance are highlighted. A literature review of empirical studies on Islamic banking is presented in section 4. Data and methodology are tackled in section 5. The empirical results and analysis are discussed in section 6. Finally, section 7 concludes.

2 Structural Differences between Islamic and Conventional Banks

The financial transactions of commercial banks are based on interest and the concept of the relationship between the debtor and the lender. Accordingly, the profit of a commercial bank is the variance between the amount of interest that has been paid to the depositors and the interest that has been charged to the borrowers [2]. Furthermore, other financial transactions are provided by commercial banks, including letters of credit and guarantees, and they also produce different kinds of derivatives.

On the other hand, the Islamic banking system works according to the concept of the partnership that emerges between the banks and the depositors. It is a relationship of profit and loss sharing (PLS) which allows both parties to go forward in owning physical goods and undergoing trading processes [3]. The depositors in the Islamic banking system are recognised as entrepreneurs. Therefore, Mudaraba, Musharaka, Murabaha, Ijarah, Bai Muajal, Bi slam and prepaid purchase are considered the best substitutes for the Islamic banks to avoid interest, which is clearly forbidden in Islam [4]. Four main rules govern the investment behavior of Islamic banking, namely:

a. the absence of interest-based (riba) transactions;
b. the avoidance of economic activities involving speculation (ghirar).
c. the introduction of an Islamic tax, Zakat.
d. the discouragement of the production of goods and services which contradict the value pattern of Islam (Haram).

3 Elements of Islamic Banking and Finance

Individual banks differ in their application. These differences are due to several reasons including the laws of the country, objectives of different banks, individual banks circumstances and experiences, and the need to interact with other interest-based banks. However, there are salient features common to all Islamic banks. All Islamic banks have three kinds of deposit accounts: current, savings and investment.

1. *Current accounts*: Current or demand deposits are virtually the same as in all conventional banks. Deposit is guaranteed.
2. *Savings accounts*: Savings deposits operate in different ways. In some banks, the depositors allow the banks to use their money but they obtain a guarantee of getting the full amount back from the bank. Banks adopt several methods of inducing their clients to deposit with them, but no profit is promised. In others, savings accounts are treated as investment accounts but with less stringent conditions as to withdrawals and minimum balance. Capital is not guaranteed but the banks take care to invest money from such accounts in relatively risk-free short-term projects.
3. *Investment accounts*: Investment deposits are accepted for a fixed or unlimited period of time. The investors agree in advance to share the profit (or loss) in a given proportion with the bank. Capital is not guaranteed.

On the other hand, banks adopt several modes of acquiring assets or financing projects. But they can be broadly categorized into three areas: investment, trade and lending.

I-Investment financing: This is done in different ways:

a) Musharaka, where a bank may join another entity to set up a joint venture, both parties participating in the various aspects of the project in varying degrees. Profits are divided on a pre-detemined basis, and any losses are shared in proportion to the capital contribution.

b) Mudarabha, where the bank contributes with the finance and the client provides the expertise, management and labor. Profits are shared by both partners in a pre- arranged proportion, but when a loss occurs the total loss is borne by the bank.

c) Murabaha, was originally an exchange transaction in which a trader purchases items required by an end user. The trader then sells those items to the end-user at a price that is calculated using an agreed profit margin over the costs incurred by the trader. To be in consonance with the principles of Islamic finance governing exchange transactions, every Murabaha transaction must meet the following conditions: Murabaha transactions may be undertaken only where the client of a bank wants to purchase a commodity. To make it a valid transaction, it is necessary that the commodity is really purchased by the bank and comes into the ownership and possession (physical or constructive) of the bank so that it may assume the risk of the commodity. After acquiring the ownership and possession of the commodity it should be sold to the client through a valid sale.

D) Ijarah, in the context of Islamic banking, can be defined as a process by which "usufruct of a particular property is transferred to another person in exchange for a rent claimed from him". In many respects, Ijarah resembles leasing as it is practiced in today's commercial world. The distinguishing feature of this mode is that the assets remain the property of the Islamic bank to put them up for rent every time the lease period terminates so as not to remain unutilized for long periods of time. Under Ijarah, the bank, or the leasing company, assumes the risk of recession or diminishing demand for these assets.

E) Istisna, is a second kind of sale where a commodity is transacted before it comes into

existence. However, it is necessary for the validity of Istisna that the price is fixed with the consent of the parties. Also, the necessary specifications of the commodity are fully settled between them.

F) Salam or Bay-Salaam, as it's also called, is a sale whereby the seller undertakes to supply some specific goods to the buyer at a future date in exchange for an advanced price fully paid on the spot. Salam sale is suitable for the finance of agriculture operations, where the bank renders great services to the farmers in their way to achieve their production targets. Salam sale is also used to finance commercial and industrial activities, especially phases prior to production and export of commodities. That is, by purchasing them on Salam and marketing them for lucrative prices.

II- Trade financing: This is also done in several ways. The main ones are:

a) Mark-up, where the bank buys an item for a client and the client agrees to repay the bank the price and an agreed profit later on.

b) Leasing, where the bank buys an item for a client and leases it to him for an agreed period. At the end of that period, the lessee pays the balance on the price agreed upon at the beginning and becomes the owner of the item.

c) Hire –purchase, where the bank buys an item for the client and hires it to him for an agreed rent and period. At the end of that period the client automatically becomes the owner of the item.

d) Sell-and-buy-back, where a client sells one of his properties to the bank for an agreed price payable now on condition that he will buy the property back after certain time for an agreed price.

e) Letters of credit, where the bank guarantees the import of an item using its own funds for a client on the basis of sharing the profit from the sale of this item or on for mark-up basis.

III-Lending: Main forms of lending are:

a) Loans with a service charge, where the bank lends money without interest but they cover their expenses by levying a service charge. This charge may be subject to a maximum set by the authorities.

b) No-cost loans, where each bank is expected to set aside a part of its funds to grant no-cost loans to needy persons, such as small farmers, entrepreneurs, producers, etc., and to needy consumers.

c) Overdrafts, are to be also provided, subject to a certain maximum, free of charge.

Other banking services such as money transfers, bill collections, trade in foreign currencies at spot rate etc., where the bank's own money is not involved, are provided on a commission or charges basis. Islamic banks financing is granted on the basis of either of three modes: sharing, sale or leasing.

4 Literature Review

While several good theoretical studies on Islamic banking are available, there is a serious shortage of empirical studies. The most important reason for the lack of empirical studies on Islamic banking is the lack of a long and consistent time series for Islamic banks. There are so many variations in practices of reporting financial statements that construction of a consistent time series is a project in itself.

Existing studies in this area are classified into two groups. The first group includes studies that assess the performance of Islamic banks using traditional financial ratios [5 – 8]. Some of those studies compared their results with conventional banks. The second group of studies focuses on banks efficiency and utilizes frontier analysis approaches rather than traditional financial ratios. Studies in this group can be divided into three folds: i) studies that evaluate efficiency of Islamic banks [9 – 12], ii) studies that assess conventional banks' efficiency [13 – 15], and iii) studies that compare the efficiency of Islamic with conventional banks [8, 16 – 18].

Awan (2009) [19] analyzed the vertical growth of Islamic banking and compared it with its counterpart conventional banking. Six newly formed Islamic banks in Pakistan and six conventional banks of the same size were selected for the purpose of comparison. Data relating to their performance and profitability were collected from primary and secondary sources from 2006 to 2008. The ratio analysis technique was applied to measure the performance of key indicators of both Islamic and conventional banks. The results of the study were very encouraging. Islamic banks outperformed conventional banks in assets, deposits, financing, investments, efficiency, and quality of services and recovery of loans. It predicted the bright future of Islamic banking in Pakistan.

Iqbal (2001) [20] used data for the 1990-98 period. For this study, a sample of twelve Islamic banks was chosen. These banks together account for more than 75 percent of total capital as well as total assets of "private" Islamic banks and thus form a very large sample from a statistical point of view. Therefore, it can be safely assumed that the results derived from this sample were representative of the "Islamic banking industry". For comparative purposes, another sample of twelve conventional banks was chosen. These banks were chosen from exactly the same countries from where Islamic banks were chosen. An attempt was also made to choose banks roughly of the same size as the Islamic banks. Several hypotheses and common perceptions about the practice of Islamic banking have been tested. The performance of Islamic banks has been evaluated using both trend and ratio analyses. For this purpose, some objective "benchmarks" for various ratios have been developed for the first time. The performance of Islamic banks has also been compared with a 'control group' of conventional banks. It was found that, in general, Islamic banks have done fairly well during the period under study.

Jaffer and Manarvi (2011) [21] examined and compared the performance of Islamic and conventional banks operating inside Pakistan during 2005 to 2009 by analyzing CAMEL test standard factors, including capital adequacy, asset quality, management quality, earning ability and liquidity position. The financial data for the study was mined from the banks' financial statements existing on state bank of Pakistan website. A sample of 5 Islamic banks and 5 conventional banks were selected to measure and compare their performance. Each year the average ratios were considered, because some of the young Islamic banks in the sample do not have 5 years of financial data. The study found that Islamic banks performed better in possessing adequate capital and better liquidity position, while conventional banks pioneered in management quality and earning ability. Asset quality for both modes of banking was almost the same. Conventional banks recorded slightly smaller loan loss ratios showing improved loan recovery policy whereas, UNCOL ratio analysis showed a nominal better performance for Islamic banks.

Hanif, et al. (2012) [22] analyzed and compared the performance of Islamic and conventional banking in Pakistan. For this study, a sample of 22 conventional banks and 5 Islamic banks were selected. Key performance indicators were divided into external and internal bank factors. The external factor analysis included studying the customer

behavior and perception about both Islamic and conventional banking. Internal factor analysis included measures of differences in performance of Islamic and conventional banks in terms of profitability, liquidity, credit risk and solvency. Nine financial ratios were used to assess profitability, liquidity and credit risk; and a model known as "Bank-o-meter" was used to assess solvency. In terms of profitability and liquidity, conventional banking leads. However, in credit risk management and solvency maintenance Islamic banking dominates. Motivating factors for customers of Islamic banking were the location and Shari'a compliance, while in case of conventional banking it was the wide range of products and services.

Rosly and Abu Bakar (2003) [23] found that Islamic banking scheme (IBS) banks in Malaysia have recorded higher return on assets (ROA) as they were able to utilize existing overheads carried by mainstream banks. As this lowers their overhead expenses, it was found that the higher ROA ratio for IBS banks did not imply efficiency. It was also inconsistent with their relatively low asset utilization and investment margin ratios. This finding confirmed the contention that Islamic banking that thrives on interest-like products (credit finance) was less likely to outshine mainstream banks on efficiency terms. Although Islamic credit finance products may have complied with Shariah rules, their lack of ethical content was not expected to motivate IBS banks to strive for efficiency through scale and scope economies.

Safiullah (2010) [24] emphasised on the financial performance analysis of both streams of banks to measure superiority. The study indicated that financial performance (business developments, profitability, liquidity and solvency, commitment to economy and community, efficiency and productivity) of both streams of banks is notable. Study results, based on commitment to economy & community, productivity and efficiency, signified that interest-based conventional banks were doing better than interest-free Islamic banks. But performance of interest-free Islamic banks in business development, profitability, liquidity and solvency was superior to that of interest-based conventional banks. That is, comparatively Islamic banks were superior in financial performance to that of interest-based conventional banks.

Samad (2004) [25] examined the comparative performance of Bahrain's interest-free Islamic banks and the interest-based conventional commercial banks during the post-Gulf War period with respect to (a) profitability, (b) liquidity risk, and (c) credit risk. Nine financial ratios were used in measuring these performances. Applying Student's *t*-test to financial ratios for Islamic and conventional commercial banks in Bahrain for the period 1991-2001, the paper concluded that there was no major difference in performance between Islamic and conventional banks with respect to profitability and liquidity. However, the study found that there exists a significant difference in credit performance.

Siraj and Pillai (2012) [26] investigated the presence, if any, of similarity in growth of chosen performance indicators of conventional and Islamic banks in the Gulf Cooperation Council (GCC) region. The study selected six Islamic banks and six conventional banks. A comparative study was undertaken based on performance indicators such as Operating Profit Ratio (OER), Net Profit Ratio (NPR), Return on Asset (ROA), Return on Share capital (ROCA) and Return on Total Equity (ROE). Inferences based on analysis revealed better performance of Islamic banking during the study period. The analysis revealed that Islamic banks are more equity financed than conventional banks. ANOVA showed the presence of a significant relationship in movement of selected financial indicators. Conventional banks registered growth in revenue during the period, but could not achieve improved profitability on account of higher provisions towards credit losses and

impairment losses. The performance indicators were affected by financial crises as may be noted from the recessionary trends since 2007.
Usman and Khan (2012) [27] evaluated the comparative financial performance of Islamic and conventional banks. Profitability and liquidity ratios of Islamic banks (Mezan Bank Ltd, Bank Islamic and Albaraka) and conventional banks (Faysal Bank, KASB and Bank of Khyber) were used during the period from 2007 to 2009. The sampled banks were selected on the basis of almost having equal weight of invested capital and number of existing branches. To make substantially noteworthy results, paired sample t-tests were used. The results showed that Islamic banks have high growth rates and profitability over the conventional banks. Moreover, Islamic banks had high liquidity power over conventional banks.

5 Data and Methodology

The ratio analysis is a method of calculating and interpreting financial ratios to asses bank performance. In order to compare performance of Islamic and conventional banks in Egypt for the period of 2008-2010, the study uses inter-bank analysis for 3 Islamic and 6 conventional banks, as reported in table 1.

Table 1: Sample of Islamic and Conventional Banks

Islamic Banks	**Conventional Banks**
Faisal Islamic Bank	National Bank of Egypt
ElBaraka Misr	Banque Misr
National Bank for Development	Bank of Alexandria
	National Societe Generale Bank
	Arab African International Bank
	Commercial International Bank

The study evaluates inter-bank performance of Islamic and conventional banks in term of profitability, liquidity, credit risk and solvency. Banks performances are measured on set critical factors that are thought to be specific to performance of any bank. The required ratios are calculated and necessary arithmetical and statistical workings are done to see the performance year wise. After all the workings, there are separate values for every bank year wise. Then, means and standard deviations are computed to measure the performance sector wise. This gives two comparative values for each portfolio i.e. Islamic and conventional banks on key performance indicators (KPIs), which are the basis of the conclusion. Main source of data used in the study is secondary data extracted from financial statements of banks. The study uses seven financial ratios to evaluate bank performances. These ratios are grouped under four broad categories.

1. Profitability

It is one of the widely used performance indicators to measure the performance of any business. Like all other businesses, banks earn profit when their income is more than their expenses. Profitability ratios depict banks overall performance and efficiency. In this study,

profitability is measured by Return *on Assets (ROA)*, which is equal to *Net Profit/Total Assets*. ROA has been used in a lot of studies to measure the performance of banks [25, 28, 29]. Another ratio is *Return on Equity (ROE)*, which is equal to *Net Profit/Equity*. ROE measures the efficiency of banks in making profits from every unit of shareholders equity [30]. The higher the ROE, the more efficient the bank performance is.

2. Liquidity

Maintaining liquidity in all circumstances is one of the major challenges that banks face. Liquidity of a bank means the ability of a bank to meet the financial obligations as and when due. Liquidity is a prime parameter of banking risk. It is measured by *Net Loans to Asset Ratio (NetLTA)* calculated as *Net loans/Asset Ratio*. This ratio shows the percentage of loans that are rooted in assets. The higher this ratio, the lower is the banks liquidity and thus the more risky a bank is to higher defaults. Another ratio used is *Net Loans to Deposits and Borrowing (NetLD&B)*, which is equal to *Net Loans/Total Deposits and Borrowing*. This ratio depicts the percentage of total deposits and borrowings that are entrenched into non-liquid asset. The higher the LDBR, the higher is the chance that bank faces liquidity risk.

3. Credit Risk

Credit risk is the risk of loss that arises from a borrower's inability to meet his obligations. For any financial institution measuring and managing credit risk is very important. The first ratio used to gauge credit risk is *Total Equity to Net Loans (EQL)*, which is equal to *Total Equity/Net Loans*. EQL provides equity as a cushion to take in or adjust loan losses faced by a bank. The higher the ratio of EQL, the higher is the capacity for a bank in absorbing loan losses. The second parameter used is *Impaired Loans to Gross Loans (IMLGL)*, calculated as *Impaired Loans/Gross Loans*. This ratio indicates the percentage of nonperforming loans or doubtful loans to gross loans that a bank has on its books. This ratio also assesses the quality of assets or loans of the bank. The lower the ratio of IMLGL, the better is the asset/credit performance of the bank. The ability to predict weakness and reliability of banks in financial distress is of vital importance to central banks, creditors and equity investors.

4. Solvency

When a bank goes insolvent, creditors often lose a portion of principal and interest payments, while equity investors can potentially lose all of their investment. To measure solvency of banks, a model, known as Bank-o-meter developed by Shar, et al. (2010) [31] is used. Bank-o-meter has a quality that it uses minimum parameters and gives more accurate results on solvency of banks. Shar, et al (2010) [31] used the following parameters in this model:

$$S = 1.5* CA+1.2*EA +3.5* CAR+0.6*NPL+0.3*CI+04*LA$$

where '**S**' stands for solvency
CAR stands for capital adequacy ratio
CA stands for capital assets ratio
EA stands for equity to assets
NPL stands for non-performing loans to loans
CI stands for cost to income
LA stands for loans to assets

And 50<**S**<70. All banks having 'S' value greater than 70 are solvent and termed as super sound banks, while those having 'S' value below 50 are not solvent. The area between 50 and 70 is defined as gray area because of the susceptibility to error classification [31, 32].

6 Empirical Results and Analysis

Results of the financial analysis are presented in table 2, covering the four core areas of profitability, liquidity, credit risk and solvency through simple sectorial averages for both streams of banking.

Table 2: Financial Performance of Islamic Versus Conventional Banking

Performance Measures	**Islamic Banks**	**Conventional Banks**	**Comments**
Profitability			Conventional Banks lead in profitability
ROA	-1.37%	1.5%	
ROE	-28.7%	20%	
Liquidity			Conventional Banks lead in liquidity management
NetLTA	48.43%	43.77%	
NetLD&B	53.37%	55.3%	
Credit Risk			Conventional Banks lead in credit risk management
EQL	14.88%	15.23%	
IMLGL	36.11%	15.42%	
Solvency	1.15	1	Islamic Banks lead in solvency management

From the previous table, it is clear that conventional banks lead in the majority of the performance indicators. Profitability, whether measured by ROA or ROE, is higher in conventional banks. This indicates that assets of conventional banks are capable of yielding more return than Islamic ones. Also, conventional banks appear to be more efficient in generating profits from every unit of shareholders equity.

Liquidity risk of portfolios of both banking streams is depicted by NetLTA and NetLD&B ratios. NetLTA ratio of Islamic banks exceeds that of conventional banks. This indicates that conventional banks are more liquid than Islamic ones, showing that the latter are more tied up in loans. As for the NetLD&B ratio, it is slightly higher in conventional banks. This shows that conventional banks face more liquidity risk than Islamic banks. However, overall liquidity management of conventional banks is better than Islamic banks.

Two different indicators were used to measure credit risk of Islamic and conventional banking; namely, EQL and IMLGL. EQL of conventional banks is slightly more than that of Islamic banks. This shows that conventional banks are more proficient than Islamic banks in absorbing loan losses. IMLGL of Islamic banks is much higher than that of conventional banks. This depicts the fact that the quality of assets or loans of the Islamic banks is worse than that of conventional banks. Credit risk performance of conventional banks is better than that of conventional banks.

Finally, solvency of both banking streams, measured by the Bank-o-meter, reflects the insolvency of the whole banking sector. However, the Islamic banks have a slightly higher value.

In this study, it was not only traced out which banking medium is performing ahead of the other, but it was also traced out which of the banks in each banking stream is performing better than all others in terms of profitability, liquidity, credit risk and solvency. This is explicitly depicted in table 3.

Table 3: Leading Banks in each Banking Stream

Performance Measures	**Leading Islamic Banks**	**Leading Conventional Banks**
Profitability		
ROA	Elbaraka Misr	Commercial International Bank
ROE	Elbaraka Misr	Commercial International Bank
Liquidity		
NetLTA	National Bank for Development	Banque Misr
NetLD&B	National Bank for Development	Banque Misr
Credit Risk		
EQL	Faisal Islamic Bank	Bank of Alexandria
IMLGL	Elbaraka Misr	National Societe Generale Bank Arab African International Bank Commercial International Bank
Solvency	National Bank for Development	Banque Misr

7 Conclusion

This paper compares the financial performance of 3 Islamic and 6 conventional banks in Egypt during the period 2008-2010. The comparison of financial measures, expressed in terms of various financial ratios, indicates the superiority of conventional banks over Islamic ones in profitability, liquidity, credit risk management and solvency. The findings indicate that Islamic banks still have a long way to go.

The experience of Islamic banking in Egypt presents an aberration from the theoretical

framework of Islamic finance and a clear deviation from its objectives. The gap between the theoretical foundations and practice can be attributed to a set of obstacles Islamic banks are facing; for example:

1. Shortage of experts in Islamic banking
2. Absence of accounting and auditing standards special to Islamic banks
3. Lack of uniform standard of credit analysis, especially for PLS schemes
4. Potential conflicts with the Central Bank
5. Potential conflict between conventional and Islamic banks
6. PLS-financing is unpopular with both Islamic banks and clients
7. PLS is not suitable for short term financing or for the non- profit sector
8. There is a lack of developed Islamic financial products, institutions and markets
9. Lack of knowledge of Islamic financial products

However, several solutions could be suggested to overcome some of these obstacles. To avoid shortage of experts in Islamic banking, training institutions can be established to qualify Islamic banking staff. The proposed center may take the form of a university or an academy to teach Islamic banking sciences. The purpose of such academy is to prepare, train, and graduate banking cadres that are practically and scientifically qualified for working in Islamic Banks.

The sound efforts of the Accounting and Auditing Association of Islamic Financial Institutions cannot be neglected in the field of developing the accounting and auditing aspects of the Islamic financial institutions. This is evident in its introducing these aspects and their applications by providing training opportunities. However, the Association needs to acquire some sort of professionalism to enforce the application of the said regulations and standards.

Moreover, potential conflicts with the Central Bank need more understanding and support from the side of such supervisory bodies through certain effective measures. For example, there should be a special department in the Central Bank to inspect, audit, and supervise Islamic banks dealings. The policies of monetary reserves and the credit ceilings should be reconsidered. There is also a great need for designing models and periodical data sheets required from Islamic banks in agreement with the Central Bank, to satisfy both the supervisory objectives and the nature of Islamic banking system.

Concerning the potential cooperation between conventional and Islamic banks, several ways could be suggested to strengthen and deepen this relation. This could be done through increasing and expanding joint investments between both systems, whether on the governmental level or the mutual one subject to the regulations and rulings of Islamic *Sharia.* Also, through increasing the automation between the two systems, so that Islamic banks can move forward. And, finally, through establishing an advanced network for financial banking, as well as domestic and international markets conditions, to support the objectives of the two systems.

Last, but not least, there should be some sort of coordination among all the Islamic banking units operating in the Islamic and non-Islamic countries on how to face the problem of knowledge and informative advertising. Cooperation should focus on organizing joint exhibitions to promote and market Islamic banking products and services and introducing different modes of finance. The Islamic banking current infrastructure can be used, such as The General Council for Islamic banks and financial institutions, the Islamic Development Bank, and the Islamic Financial Services Council in Malaysia. In addition to this, traditional advertising techniques will also be useful, such as the

audio-visual methods, direct contact with bank clients, as well as the photographed advertising leaflets and brochures that are sent by mail to clients and placed in the bank halls.

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